

Decision **DRAFT DECISION OF ALJ EVANS** (Mailed 2/11/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of KERMAN
TELEPHONE CO. (U 1012 C) to restructure
intrastate rates and charges for telephone services
furnished within the State of California.

Application 02-01-004
(Filed January 4, 2002)

**OPINION ESTABLISHING INTERIM RATES
FOR KERMAN TELEPHONE COMPANY**

I. Summary

This decision grants Kerman Telephone Company's (Kerman) motion for interim rate relief subject to true-up. We find that interim rate relief is necessary due to delays in this proceeding as well as to the deterioration of Kerman's earnings.

II. Background

A. Kerman Telephone Company

Kerman owns and operates a telephone system that provides local exchange telephone service to some 6,800 customers in the City of Kerman and in surrounding unincorporated areas of Fresno County. Kerman is located approximately 15 miles west of the City of Fresno on State Route 180.

B. Advice Letter No. 291

On June 1, 2001, Kerman filed for a general rate case (GRC) via Advice Letter (AL) No. 291 with the Commission's Telecommunications Division (TD). Kerman asked for a revenue increase based on a 2002 test year of \$2.255 million,

which would have produced a 12.25% rate of return on an intrastate rate base of approximately \$4,079,125.

Kerman provided notice to its customers by bill insert as well as by an advertisement in the Kerman Newspaper in June of 2001. There were no customer complaints pertaining to Kerman's AL filing, but the Commission's Office of Ratepayer Advocates (ORA) filed a protest to AL No. 291 on July 5, 2001.

Both ORA and TD raised issues with Kerman pertaining to the proposed rate design, revenue requirement, and Kerman's construction program. Kerman, ORA, and TD attempted to resolve these issues, but to no avail. On November 29, 2001, almost six months from the date of filing, the Commission approved TD's Resolution No. T-16597, which rejected Kerman's AL without prejudice. The Commission ordered Kerman to resubmit its GRC filing by application, no later than March 31, 2002 for a 2003 test year. Kerman complied and filed its application on January 4, 2002.

In Resolution No. T-16597, the Commission provided a list of items or issues that Kerman must address or comply with in its application. In addition, the Commission ordered ORA to conduct an audit of the affiliated transactions and jurisdictional separation practices of Kerman. Kerman was also ordered by the Commission to fund the audit.

C. Application 02-01-004 and Kerman's Motion for Interim Rate Relief

Kerman filed its application on January 4, 2002, in compliance with Resolution No. T-16597. Kerman states that its existing revenue sources are not producing sufficient revenues to cover its costs of operations including a reasonable return on the capital invested in the business. Kerman further states that this situation became apparent in 2000 and led to the filing of a GRC AL

filing on May 31, 2001.¹ Kerman estimated its revenue shortfall for a 2002 test year in the June 1, 2001 AL filing to be \$2.255 million. In this application with a 2003 test year, Kerman estimates the revenue shortfall to be \$2.579 million.

Kerman notes that the primary factors driving these revenue requirement increases are additional plant investment and increased operating expenses. Under the toll and access settlement arrangements between the small local exchange telephone carriers and Pacific Bell, which were in effect until early 2001, but were terminated by this Commission's Decision (D.) 01-02-018, year-to-year increases and decreases in investment and expense levels would produce compensating increases or decreases in settlement revenues. These settlement adjustments reduced the frequency of required GRC filings for small companies that participated in the settlement pools. Now that the settlement pools have been terminated, a company in Kerman's circumstances must resort to a GRC filing to obtain the revenues needed to meet increased costs of operation.

At the February 26, 2002 prehearing conference (PHC), Kerman argued its position for interim rate relief, and ORA argued against it. It became apparent at the PHC that ORA's participation in the GRC could not comport with the rate case schedule proposed by Kerman in its application. In fact, ORA's proposed schedule, which would later be lengthened, proposed an April 2003 completion date, some five months later than the schedule proposed by Kerman. The major difference in the parties' proposed rate case schedules, is the delay in obtaining a consultant to perform the Commission-ordered audit. This delay became even more apparent when ORA, in response to the assigned Administrative Law Judge's (ALJ) Ruling of June 6, 2002, provided its latest estimate of when it could

¹ The actual filing date is June 1, 2001.

complete its work. In ORA's response to the ALJ's ruling, ORA proposed a revised rate case schedule that, at best, would most likely not allow for a final decision in this matter before June 30, 2003, almost 18 months from filing and 2 years from Kerman's initial GRC AL filing on June 1, 2001. Clearly we cannot meet Kerman's proposed schedule as filed. While ORA's showing is delayed due to the difficulty in obtaining the Commission mandated auditor, just as clearly, Kerman should not be penalized by ORA's scheduling difficulties.

D. Motion for Interim Relief

Kerman states in its motion for interim rate relief, which it filed in conjunction with the filing of its GRC on January 4, 2002, that its request of \$1,937,350 is based on its currently authorized rate of return of 10%. Kerman proposes to recover this amount as an addition to its 2002 California High Cost Fund-A (CHCF-A) funding. This additional draw would bring Kerman's CHCF-A draw to a total of \$4,769,015. Kerman notes that without this additional \$1,937,350, for the estimated year 2002 it will earn a negative rate of return of 3.9%. Kerman states that the requested rate authorization would further be subject to true-up in the final order on this application, to reflect any adjustments to the filed test year that may be made during the course of this GRC application proceeding.

Kerman notes that it has removed the primary issue of controversy that arose in its AL GRC filing by utilizing its existing or authorized rate of return of 10% for the limited purposes of interim rate relief. Kerman states that it discussed this approach in seeking interim rate relief for 2002 with the TD when it was informed that the AL GRC would be dismissed.

Kerman states that it followed all the rules; it used established procedures for small telephone companies seeking general rate relief pursuant to

the Commission's General Order 96-A. It notes that had the AL been processed in accordance with standard procedures, the Resolution approving the filing would have been issued in January 2002.

The company notes in its filing that the Commission has in the past granted interim rate relief to preserve financial integrity of a utility and cites those cases.²

As a result of ORA's response to the ALJ's June 6, 2002 ruling, on June 18, 2002, Kerman responded to ORA's new timeline for completing the case, reiterating its request for interim relief and a request to shorten ORA's proposed schedule.

On November 8, 2002, the Assigned Commissioner's ruling and scoping memo set forth the issues and noted that the request for interim relief will be carefully evaluated.

III. Discussion

A. AL GRC Process vis-à-vis the Formal Application Process

The AL GRC process is different from the formal GRC application process. The industry division, in this case the TD, performed the AL analysis, worked closely with Kerman, and ultimately provided a recommendation by

² In *Ponderosa Telephone Company*, D.84-03-016, 14 CPUC 2d 390 (1984), the Commission granted a small telephone company a 16.6% interim rate increase in the face of projected losses in order to preserve its financial condition.

In D.01-01-018 the Commission stated:

"...the Commission's authority to grant interim rate relief in an emergency situation is well established. The California Supreme Court has recognized this authority on several occasions, most recently and expansively in *TURN v. CPUC*, 44 Cal. 3d 870 (1978)." (2001 Cal. PUC LEXIS 44.)

resolution for the Commission's approval. There are no hearings, although there may be public meetings to obtain customer input. Interested parties and customers may file protests, as ORA did in this case. Depending upon the nature of the protests, the responses of the utility (Kerman), as well as the industry division's (TD) analysis of the filing, the division may decide that the issues are too complicated or too controversial to be handled by an AL filing. As a result, rather than continuing to process the AL, the industry division will recommend to the Commission, in the form of a resolution, that the Commission reject the AL without prejudice and order the utility (Kerman) to file a formal application. That occurred here. A resolution rejecting Kerman's AL GRC filing and recommending that Kerman file a formal application addressing the issues delineated in the resolution was approved by the Commission on November 29, 2001.

In this particular formal application, all the issues covered in the resolution, and others, will be addressed. Hearings will be held; witnesses will testify and be subject to cross-examination; briefs will be filed; oral argument will be made; and finally a proposed decision will be prepared by the assigned ALJ.

B. Is Interim Rate Relief Warranted?

Kerman claims that interim rates are warranted due to its financial emergency. The Commission has the authority to set interim rates and has done so on numerous occasions. Despite ORA's argument to the contrary, interim rates need not be premised on an "emergency" alone, but can be adopted for other reasons, including procedural delays. The California Supreme Court addressed precisely this issue in *TURN v. CPUC* (44 Cal. 3d 870, 878 (1988)). In the underlying decision, the Commission granted an interim rate increase while expressly declining to make any finding that "the interim rate increase was

required by a financial emergency, or that the reasonableness of the pertinent costs was undisputed.” (*Id.* at 875.) The Commission’s decision was upheld by the Supreme Court, which found that the overriding circumstance was the prospect of many months and years of hearings and deliberations before a final rate could be determined. (*Id.* at 879.)³ The court affirmed that the Commission could set interim rates as long as the rate is subject to refund and sufficient justification for the interim relief has been presented. (*Id.* at 880.)⁴

Kerman makes a plea that the company followed all the rules in filing for its AL GRC. Perhaps it did follow all the rules, but the Commission found that there were just too many issues that needed resolution and as a consequence it approved TD’s rejection of Kerman’s filing without prejudice. Kerman then refiled with a formal application as ordered in Resolution T-16597.

Unfortunately for Kerman, this added an additional seven months to its GRC process, June 1, 2001 to January 4, 2002, the filing date of this application.

We can see with certainty that this application is very unlikely to be completed before June 2003, two years from the filing of Kerman’s AL GRC filing and almost 18 months from the filing of this application.

The dilemma that we now face is: Is Kerman experiencing a financial emergency? Are Kerman’s figures, which are untested at this time, (but will be,

³ See also *Re Southern California Edison Company* (28 CPUC 2d 203, 212 (1988) D.88-05-074), which held that “the existence of a financial emergency is no longer a standard which must be met in granting interim relief.” The order also notes that full consideration of the issues in the case has delayed the case and is another factor in granting interim relief. (*Id.* at 212.)

⁴ The adoption of interim rates is not limited to energy matters. (See 80 CPUC 462, 465 (1976) D.86352, wherein the Commission approved “interim provisional rates” at the request of Pacific for its “Dimension PBX” service as a result of delays in the proceeding to establish permanent prices for the service.)

following our hearing process) truly indicative of its current and future financial position? Of course if we wait for the completion of the rate case process, we will know the answer; but that will not be before June 2003 at best, two years from when Kerman first filed its advice letter GRC. In order to even consider interim relief, we need some indication of whether Kerman's estimated 2002 and 2003 negative earnings estimates are "in the ball park." At the PHC on February 26, 2002, the assigned ALJ anticipated this conundrum and directed Kerman to provide the filing of (1) separated results of operation for year 2001, (2) an advance copy of the "Form M" report to the Commission, also reflecting recorded results for 2001, and (3) a cash flow analysis of recorded 2001 and estimated 2002 operations, reflecting both total company and intrastate operations.

In response to the ALJ's request, Kerman provided its intrastate results of operations for the recorded year 2001, which yields a rate of return of 7.36%. That figure, 7.36% is significantly less than the requested rate of return of 12.25% and less than the 10% approved for Kerman in 1997.

Kerman's request for interim rate relief is predicated on its as yet untested showing. Nevertheless, Kerman estimates, as shown in Exhibit B of the motion for interim rate relief, that its test year 2002 intrastate rate of return will be a negative 3.90% or a negative \$331,964. In other words, Kerman's estimated expenses exceed its estimated revenues by so much that the company is not even breaking even, let alone providing a return to Kerman's investors.

C. Cash Flow Analysis

Kerman provided us with its cash flow analysis of 2001 actual and 2002 estimated for both total company⁵ and intrastate operations. We tested Kerman's claim of financial emergency by examining the data provided in its cash flow analysis for recorded year 2001 and estimated year 2002. We were able to trace the figures shown for the recorded year 2001 to the recorded 2001 annual report, the "Form M." We examined Kerman's estimates for its 2002 cash flow analysis and are satisfied with the reasonableness of those figures as we were able to derive similar ones based on the ratios between total company and intrastate operations and to the budgeted and estimated amounts shown in Kerman's showing for 2002.

Kerman's cash flow analysis is slightly modified and reproduced below:

⁵ Total company is defined as total "utility operations." Non-utility operations are not included. The difference between total company and intrastate (or state) is the interstate operations.

Line No.	Item	2001 Actual Total Co.	2001 Actual State Only	2002 Estimated Total Co.	2002 Estimated State Only
1	Beginning Cash	\$303,000	\$167,000	\$749,000	\$466,000
	Add:				
2	Net Income	890,000	623,000	48,000	(197,000)
3	Depreciation	1,601,000	1,242,000	1,886,000	1,445,000
4	Capital Contributed ⁶	983,000	757,000	-	-
5	Increase/decrease in Payables ⁷	1,701,000	1,310,000	(1,701,000)	(1,310,000)
6	Other Misc. Changes in Assets/Liabilities	281,000	197,000	-	-
7=lines 2 thru 6	Subtotal Adds (Lines 2 thru 6)	5,456,000	4,129,000	233,000	(62,000)
8	Less				
9	Capital Expenditures	4,557,000	3,509,000	5,876,000	4,525,000
10	Debt Repayment	53,000	41,000	52,000	41,000
11	Dividends	400,000	280,000	400,000	280,000
12	Subtotal Lines 9 thru 11	5,010,000	3,830,000	6,328,000	4,846,000

⁶ Contributed funds from Kerman's parent in 2001. Included in "Add'l Debt or Equity Req'd to meet test year capital expend" (line 15) for 2002.

⁷ Amount due contract or for equipment due in 2001, but paid in 2002. Therefore cash account is smaller in 2002 by amount paid in 2002.

13=lines 7-12	Total Cash from Operations	446,000	299,000	(6,095,000)	(4,908,000)
14=lines 1+13	Ending Cash	\$749,000	\$466,000	\$(5,346,000)	\$(4,442,000)
15=lines 16-14	Add'l Debt or Equity Req'd to meet test year capital expend			\$5,964,000	\$4,758,000
16	Ending Cash			\$618,000 ⁸	\$316,000 ⁹

The above tabulation is a classical accounting cash flow breakdown. Simply stated, cash flow is crucial to companies; having ample cash on hand will ensure that creditors, employees and others can be paid on time. The figures shown, in this case are from Kerman's balance sheet, recorded for 2001 and estimated for 2002. The tabulation shows that Kerman has an ending year 2002 negative cash balance. This indicates to us that Kerman does indeed have a financial emergency. As with our analysis of Kerman's estimated earnings for 2002, a decrease in revenues, an increase in expenses and very large capital expenditures, contribute to Kerman's negative cash flow for the year 2002 estimated. We realize that our ORA staff may take issue with the levels and the methodology of Kerman's recorded (and Kerman's estimated) components of its

⁸ Total Company working cash amount shown on Kerman's separated results of operations.

⁹ Intrastate working cash amount shown on Kerman's separated results of operations.

cash flow analysis. We too hope to see a critical analysis in ORA's presentation. However, we note that ORA did not comment on our request for the cash flow analysis, other than to note that the cash flow analysis does not demonstrate actions by Kerman to mitigate its financial woes. We believe ORA missed the point. A cash flow analysis is not a tool to mitigate financial woes; it is an indication of a company's financial strength. Since we are able to trace the recorded figures Kerman provided us, and are able to derive the ratios between "total company" and "intrastate" Kerman's estimated 2002 amounts, we conclude that Kerman provided us with a reasonable snapshot of its estimated 2002 financial operations.

In summary, we find that interim relief is warranted. Kerman provides us a compelling rationale. Kerman does have a financial emergency for the year 2002 based on its cash flow estimates and most likely for the 2003 test year. An interim rate increase as proposed by Kerman via an additional \$1,937,350 draw from the CHCF-A subject to "true-up" provides ratepayer protection and is a reasonable and relatively simple solution to the interim revenue requirement increase we are ordering.

We believe that interim relief is also warranted based on the fact that by the time Kerman will have permanent rates, about two years will have passed since Kerman originally filed its AL GRC. Those two years encompass the Kerman's, TD's, and ORA' joint efforts to resolve Kerman's AL GRC filed on June 1, 2001 and the delay caused by ORA's difficulty in obtaining the Commission mandated auditor. We do not know, based on the facts presented to us by the parties, how this delay could have been avoided.

D. True-Up

Kerman proposes that any interim increase it receives be subject to true-up in the final order on the application to reflect any adjustments to the filed 2003 test year that may be made during the course of this GRC application proceeding. We concur with Kerman's proposal. We envision that should we make adjustments to Kerman's requested increase in our final order, the difference between Kerman's request and our ultimate rate award is refunded lump sum with interest to the CHCF-A Fund in the form of a credit to Kerman's 2003 draw from the Fund.

IV. Categorization

In Resolution ALJ 176-3080, dated January 4, 2002, the Commission preliminary categorized application in this proceeding as ratesetting. The Scoping Memo issued on November 8, 2002 affirmed this categorization and found that hearings will be required.

V. Comments on Draft Decision

The Commission mailed the draft decision of the ALJ in this matter to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Kerman filed comments on March 3, 2003 in support of the draft decision.

VI. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Dean J. Evans is the assigned ALJ in this proceeding.

Findings of Fact

1. On November 8, 2002, the Assigned Commissioner and ALJ issued a ruling and scoping memo identifying the issues and set forth a hearing schedule.
2. Kerman has a financial emergency.

3. There have been unavoidable scheduling delays, which have exacerbated Kerman's financial emergency.

4. Kerman is earning less than its last authorized rate of return of 10%.

5. Kerman's motion for interim rate relief would provide a 10% intrastate rate of return.

6. Interim rates are necessary.

7. Interim rates, subject to true-up with interest, harm neither Kerman nor its ratepayers.

Conclusions of Law

1. Continued scheduling delays in this case may prolong Kerman's financial emergency.

2. Interim rates are necessary due to delays in this proceeding.

3. The Commission has the authority to set interim rates.

4. In *TURN v. CPUC*, the California Supreme Court held that the Commission could set interim rates as long as the rate is subject to refund and sufficiently justified.

5. Kerman is not harmed by the interim rate levels, which are subject to true-up once final rates are determined.

6. The TD should make an additional one-time payment from the CHCF-A fund in the amount of \$1,937,350 to Kerman within 45 days from the effective date of this decision. The one-time additional payment to Kerman should be contingent on the availability of funds and the Commission and State adoption of the budgets covering the payment for the 2003 CHCF-A support.

7. The one-time additional payment to Kerman should be subject to true-up and one-time lump sum refund to the CHCF-A fund with interest calculated using the 3-month commercial paper rate when final rates/charges for Kerman

are determined. Interest payment, if any, should be calculated from the date of payment by the TD. The refund, if any, should be paid by Kerman within 45 days from the effective date of the final order in this application.

O R D E R

IT IS ORDERED that:

1. The motion for interim relief, filed on January 4, 2002 by Kerman Telephone Company (Kerman) is granted.
2. The Telecommunications Division (TD) is ordered to make an additional one-time payment from the California High Cost Fund-A (CHCF-A) in the amount of \$1,937,350 to Kerman within 45 days from the effective date of this decision. The one-time additional CHCF-A payment to Kerman should be contingent on the availability of funds and the Commission and State adoption of the budgets covering the payment for the 2003 CHCF-A support.
3. The one-time additional payment to Kerman shall be subject to true-up and refund. The refund, if any, shall be a one-time lump sum payment from Kerman to the CHCF-A fund with interest calculated using the 3-month commercial paper rate from the date of payment by the TD. The lump sum refund, including interest, shall be paid by Kerman within 45 days from the effective date of the final order in this application.

This order is effective today.

Dated _____, at San Francisco, California.